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No. 82-422

In the Supreme Court of the United States

OCTOBER TERM, 1982

JOHN C. BIERWIRTH, ROBERT G. FREESE, AND CARL A. PALADINO, PETITIONERS

v.

RAYMOND J. DONOVAN, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, after ruling that the trustees of a pension plan had violated the fiduciary duties imposed on them by Section 404 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1104, the court of appeals correctly affirmed the issuance of a preliminary injunction tailored to prevent further violations of the statute.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1A-31A), as modified by a subsequent order (Pet. App. 32A-34A), is reported at 680 F.2d 263. The opinion of the district court (Pet. App. 37A-65A) is reported at 538 F. Supp. 463.

JURISDICTION

The judgment of the court of appeals was entered on May 10, 1982 (Pet. App. 71A-72A). A petition for rehearing was denied on June 18, 1982 (Pet. App. 35A-36A). The petition for a writ of certiorari was filed on September 13, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Grumman Corporation maintains a pension plan (the "Plan") for the benefit of its employees and retirees that is subject to the provisions of the Employee Retirement

Income Security Act of 1974 ("ERISA"), 29 U.S.C. (& Supp. IV) 1001 *et seq.* During September and October 1981, petitioners John C. Bierwirth, Robert G. Freese, and Carl A. Paladino served both as trustees of the Plan and as senior executives of Grumman.[1]

On September 23, 1981, LTV Corporation announced its intention to make a $45 per share cash tender offer for 70% of Grumman's common stock and common stock equivalent instruments (Pet. App. 6A). At that time, the stock was trading between $24 and $27 per share. The offer was conditioned upon tender of a minimum of 50.01% of the common stock (*id.* at 7A).

Grumman's board of directors, which included petitioners Bierwirth and Freese, met on September 25, 1981 to consider the offer (Pet App. 7A). Relying in part on a two-page letter from Dillon, Read & Company, Grumman's investment banker, stating "in a conclusory fashion" that the tender offer was inadequate, the board voted unanimously to recommend to stockholders that they reject the offer (*id.* at 7A-8A). A few days later, Grumman filed suit in federal court to enjoin the offer, alleging violations of the antitrust and securities laws (*id.* at 4A, 8A).

Bierwirth and Freese respectively spent about 90% and 50% of their time during the weeks following the tender offer working to defeat it (Pet. App. 9A). Paladino spent all of his time preparing financial material relating to Grumman Aerospace (*id.* at 41A). On October 7, 1981, Bierwirth, Freese and Paladino, acting in their capacity as trustees,

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[1]Petitioner Bierwirth was Chief Executive Officer of Grumman. Petitioner Freese was a Vice President and the Corporation's Chief Financial Officer. Petitioner Paladino was Chief Financial Officer of Grumman's principal subsidiary, Grumman Aerospace Corporation. Bierwirth and Freese were also members of the Grumman board of directors.

met to decide whether the Plan should tender its 525,000 shares of Grumman stock (*id.* at 10A-11A). At this meeting, the trustees heard a 10-minute presentation on the requirements of ERISA from counsel employed by Grumman and discussed LTV, the Dillon, Read opinion letter, and financial projections for Grumman (*id.* at 11A). After a 30-minute discussion, the trustees allegedly concluded that tendering the Plan's shares would be detrimental to the interests of the Plan's participants and beneficiaries (*id.* at 11A-12A; Pet. 6). The trustees then discussed whether the Plan should invest in additional shares of Grumman stock (Pet. App. 12A). Although they felt that the tender offer was likely to fail and that Grumman stock would rapidly fall in price after such an event, the trustees concluded that it would nonetheless be prudent for the Plan to purchase Grumman shares up to the maximum (10% of the Plan's assets) permitted by Section 407(a)(2) of ERISA, 29 U.S.C. 1107(a)(2) (Pet. App. 13A). On the day following the meeting, Grumman and the trustees amended the trust agreement to provide that Grumman would indemnify the trustees for any liability or expense arising out of any action or inaction by the trustees absent willful misconduct or lack of good faith (*id.* at 13A, 42A).

On October 9, 1981, the Securities and Exchange Commission granted the exemption from Rule 10b-6, 17 C.F.R. 240.10b-6, thought necessary to permit the purchase, and on October 12, the trustees met briefly and authorized purchase of 1,275,000 shares of Grumman stock (Pet. App. 13A). During that day and the next, the Plan purchased 1,158,000 shares at an average price of approximately $38 per share (*id.* at 14A). The day after the purchases were completed, the district court granted Grumman's motion for a preliminary injunction against the tender offer. *Grumman Corp.* v. *LTV Corp.*, 527 F. Supp. 86 (E.D.N.Y.),

aff'd, 665 F.2d 10 (2d Cir. 1981). On October 15, the price of the stock fell to a range of $28.25-$29.50 per share (Pet. App. 14A).

2. On October 19, 1981, the Secretary of Labor brought suit under ERISA in the United States District Court for the Eastern District of New York, alleging in pertinent part that the trustees' actions in declining to tender the Plan's shares and in causing the Plan to purchase additional shares constituted a violation of the trustees' duties to act prudently and solely in the interest of plan participants and beneficiaries under Section 404(a) of ERISA, 29 U.S.C. 1104(a).[2] The complaint sought equitable relief, including restoration of losses suffered and appointment of an investment manager to handle transactions involving Grumman stock. The Secretary also moved for a preliminary injunction.

After hearing argument and considering exhibits and deposition testimony submitted by the parties, the district court concluded that "[p]laintiff has shown a likelihood of success on his claim that each of the trustees has acted

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[2]Section 404(a)(1) of ERISA, 29 U.S.C. (& Supp. IV) 1104(a)(1), provides, in relevant part, that:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

imprudently with respect to their recent investment decisions concerning Grumman stock," and that injunctive relief was necessary to prevent "further violations" (Pet. App. 64A). Accordingly, the court granted the Secretary's motion for a preliminary injunction and issued an order forbidding petitioners from causing the Plan to deal in Grumman stock without a court order (*id.* at 66A-67A). The court also granted (but stayed pending appeal) the Secretary's request that an investment manager be appointed pendente lite to make decisions concerning the Grumman stock (*id.* at 67A-70A).

3. The court of appeals affirmed the grant of a preliminary injunction (Pet. App. 1A-31A).[3] The court concluded that the record before the district court justified its conclusion that the trustees had violated Section 404(a) (Pet. App. 29A). It held that Section 404(a) imposed a "high standard of duty" on the trustees and required that their decisions be made "with an eye single to the interests of the participants and beneficiaries" (Pet. App. 19A, 21A). In reviewing the largely undisputed facts before it, the court held that the trustees' conduct failed to meet the standards of Section 404 in several respects.

First, the trustees failed to seek independent legal advice concerning the tender offer when "they should have realized that * * * their judgment on this score could scarcely be unbiased" (Pet. App. 29A, 21A-22A). The counsel on whom they did rely "was under disabilities similar to those of the trustees themselves," and could hardly have been

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[3]The court of appeals considered the preliminary injunction against dealing in Grumman stock absent court approval sufficient to "protect the situation during the interval before final judgment can be entered" (Pet. App. 30A). The court therefore modified the district court's order by deleting the requirement for appointment of an investment manager pendente lite (*id.* at 31A).

expected to offer objective advice (*id.* at 22A). Second, the court observed that the trustees had failed to ascertain thoroughly the actual dangers to the Plan from the merger and had failed to explore either the "elaborate safeguards" to protect the Plan that ERISA provided or the possibility of negotiating additional ones (*id.* at 22A-26A & nn. 13, 14). Finally, the court held that even if the trustees could permissibly have purchased shares for the Plan in order to block the tender offer notwithstanding all the attendant investment risks, they should have "taken all reasonable steps" to determine whether such a purchase by the Plan was necessary to defeat the takeover attempt and justifiable as an investment (*id.* at 28A; see also *id.* at 26A-27A). The court pointed out that the trustees had caused the Plan to buy Grumman stock at the "worst possible time" and that "[i]nvestment considerations dictated a policy of waiting" because the price of the shares was bound to decline regardless of the outcome of the tender offer (*id.* at 26A-27A).

ARGUMENT

1. The decision of the court of appeals did not finally dispose of this case, but merely affirmed the grant of interlocutory relief. See Pet. App. 29A-30A. Should petitioners prevail after a trial on the merits, they will have no need for relief from this Court. Should a permanent injunction be granted by the district court and approved on appeal, petitioners may renew their contentions here. There is, accordingly, no reason for this Court to depart from its usual practice of declining to review nonfinal orders of the courts of appeals. See *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327 (1967); *Hamilton-Brown Shoe Co.* v. *Wolf Brothers*, 240 U.S. 251, 258 (1916); *American Construction Co.* v. *Jacksonville, T. & K.W. Ry.*, 148 U.S. 372, 384 (1893). The normal practice is particularly applicable here in light of the court of appeals'

willingness to rely on the relatively mild remedy of a preliminary injunction prohibiting petitioners from buying, selling, or otherwise dealing with the Plan's Grumman stock without the district court's authorization, and its consequent vacation of the more onerous requirement of the district court for the appointment of an investment manager pendente lite.

2. Review is, in any event, unwarranted because the court of appeals correctly affirmed the district court's issuance of a preliminary injunction. The standard for determining whether preliminary relief should be granted in a suit brought by the government to enforce the laws of the United States is whether the government has shown a reasonable likelihood of success on the merits and whether the balance of equities tips in its favor.[4] See *United States* v. *Atlantic Richfield Co.*, 297 F. Supp. 1061, 1067, 1073-1074 (S.D.N.Y. 1969), aff'd mem. sub nom. *Bartlett* v. *United States*, 401 U.S. 986 (1971); *United States* v. *Siemens Corp.*, 621 F.2d 499, 505 (2d Cir. 1980); *SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975). Here, the district court ruled that the Secretary had shown a likelihood of success on his claim that petitioners had violated Section 404(a) and that an injunction was necessary to prevent further violations (Pet. App. 64A). The court of appeals, which need only decide whether the district court abused its discretion, *University of Texas* v. *Camenisch*, 451 U.S. 390, 393 (1981); *Synanon Foundation, Inc.* v. *California*, 444 U.S. 1307 (1979) (Rehnquist, Circuit Justice), agreed with the district court's determinations (Pet.

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[4]The Secretary is authorized by statute to bring a civil action for injunctive relief generally to prevent violation of ERISA, see 29 U.S.C. 1132(a)(5), and specifically to enforce fiduciary requirements, see 29 U.S.C. 1132(a)(2); 29 U.S.C. 1109(a).

App. 29A, 30A).[5] As we show below, petitioners' challenges to the court of appeals' decision are without merit, and no further review of the grant of preliminary relief is warranted.

a. The court of appeals properly rejected petitioners' suggestion (Pet. 13-17) that the "prudence" and "exclusive purpose" requirements of Section 404(a) do not apply to them. Their argument rests on Section 407(a)(2), 29 U.S.C. 1107(a)(2), which prohibits a plan from acquiring or holding employer securities in excess of 10% of its assets, on Section 408(c)(3), 29 U.S.C. 1108(c)(3), which permits corporate officers and employees to serve as fiduciaries, and on legislative history of an early version of ERISA that spoke of the "symbiotic relationship existing between the employer and the plan covering his employees." S. Rep. No. 93-127, 93d Cong., 1st Sess. 33 (1973). These factors, petitioners reason, indicate a confidence in employer-trustees that makes the fiduciary restrictions of ERISA unnecessary, so long as a plan's purchases do not exceed 10% of plan assets.

But, as this Court recognized in *NLRB* v. *Amax Coal Co.*, 453 U.S. 322, 333 n.16 (1981), Section 408(c)(3) "in no way limits the duty of [a trustee who is also an employee of a sponsoring union or employer] to follow the law's fiduciary standards while he is performing his responsibilities as trustee." And, as the Conference Report on Section 407 makes plain, Congress did not create a 10% "safe harbor"; rather, the acquisition and holding of sponsoring employer securities "must also meet the rules of prudence, diversification, etc. * * * [and] must be for the exclusive benefit

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[5]Recognizing that the grant of a preliminary injunction must normally be upheld absent an abuse of discretion, the court of appeals nevertheless undertook a full review in this case because the district court's decision hinged on its legal conclusion that ERISA imposes a high standard of care on the trustees (Pet. App. 14A-16A). The court of appeals' thorough review could only have benefitted petitioners and thus furnishes them no cause for complaint.

of participants and beneficiaries." H.R. Conf. Rep. No. 93-1280, 93d Cong., 2d Sess. 320 (1974).[6] Thus, the "prudence" and "exclusive purpose" rules of Section 404(a) are fully applicable to this case. See *Eaves* v. *Penn*, 587 F.2d 453, 459-460 (10th Cir. 1978) (ERISA's prudence requirement applies to acquisition of sponsor securities by an employee stock ownership plan which, under Section 407, may invest all of its assets in sponsor securities).

b. The court of appeals was also correct in concluding that the record before the district court demonstrated that petitioners had failed to satisfy the fiduciary duties of Section 404 when they were deciding whether to tender the Plan's Grumman stock to LTV and whether to purchase additional Grumman shares as an investment for the Plan. As the court recognized, "[t]he fiduciary obligations of the trustees to the participants and beneficiaries of the plan are those of trustees of an express trust—the highest known to the law" (Pet. App. 20A n.8). Among other things, those obligations include the duty to evaluate thoroughly the risks of particular investments in light of available alternatives, *Marshall* v. *Glass/Metal Association & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Hawaii 1980), and the duty "to make independent inquiry into the merits of particular investments," *Withers* v. *Teachers' Retirement System*, 447 F. Supp. 1248, 1254-1255 (S.D.N.Y. 1978), aff'd mem., 595 F.2d 1210 (2d Cir. 1979).

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[6]The legislative history petitioners cite (Pet. 14 & n.13) is not to the contrary. The "symbiotic relationship" described in the Senate Report is qualified by a statement in the previous sentence. The 10% exemption was viewed by Congress as merely "creat[ing] a limited exception to the listed proscription against self-dealing." S. Rep. No. 93-127, *supra*, at 33. Nothing in the full passage remotely suggests that Congress also intended to create an exemption from ERISA's general fiduciary provisions.

The court of appeals noted, however, that "[t]he record contains specific instances of the trustees' failure to observe the high standard of duty placed upon them" (Pet. App. 21A).

Thus, notwithstanding the potential conflict between their duties as corporate officers and their duties as Plan trustees, petitioners did not solicit legal advice from independent counsel, who would have been without "disabilities similar to those of [petitioners] themselves" (Pet. App. 22A). Nor did they thoroughly ascertain the facts with respect to LTV's pension funds and the possible protections for the Grumman Plan available from LTV and provided under ERISA (*id.* at 22A-25A). Finally, and even more telling, the court of appeals held, petitioners did not adequately determine whether the purchase of additional Grumman shares was a sound investment or even necessary to block the takeover attempt (*id.* at 26A-28A).[7] These facts, found by the district court and affirmed by the court of appeals, do not warrant further review. See *Berenyi* v. *Immigration Director*, 385 U.S. 630, 635 (1967).[8]

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[7]The court of appeals concluded that petitioners' failure to take even these steps justified the district court's determination that they had not satisfied Section 404's requirements (Pet. App. 29A). The court, therefore, determined that it need not consider whether petitioners should have been required to take additional actions to meet their fiduciary duties (*ibid.*). We, like the court of appeals, find it unnecessary to address any additional requirements that Section 404 might impose.

[8]Petitioners incorrectly claim (Pet. 12, 17-19) that, in reaching its decision, the court of appeals held that the trustees could not consider the impact of a merger with LTV on the Grumman Pension Plan, its participants, and its beneficiaries. The court did *not* hold that petitioners were precluded from considering these factors when making investments. Instead, the court was willing to assume that they could take the merger's impact into account and could purchase stock to help defeat the tender offer (Pet. App. 28A), but held that petitioners' failure to

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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meet the "high standards" of Section 404 when taking those actions violated ERISA.

Similarly, the court did not, as petitioners imply (Pet. 16 n.15), ignore their consideration of the potential value of Grumman stock as a long term investment. The court simply found it "almost impossible to believe" that petitioners had made the purchase because of its attractiveness inasmuch as "[m]id-October 1981 was * * * the worst possible time for the Plan to buy Grumman stock as an investment" (Pet. App. 27A).